deadline in recognition of likely compliance delays given the large number of entities that would need to execute margining agreements to comply with the new initial margin requirements.[3]

The Proposal follows the revisions recommended by BCBS and IOSCO. Other United States and foreign regulators have indicated they also intend to adopt extensions. Consistency with other regulators, particularly with requirements like swap margining, helps reduce the likelihood of regulatory arbitrage.

I am concurring with the Proposal because the impact on systemic risk mitigation resulting from the partial one year delay is muted while the potential impacts on the hundreds of financial end users with smaller swap portfolios might be significant if they are not able to have margining documentation in place by the original deadline. This is a data driven conclusion. While about 40 entities have had to comply through phase 4, the OCE analysis estimates that around 700 entities with 7,000 swap arrangements would be included in phase 5. Providing more time to hundreds of smaller users of swaps should help maintain the hedging capabilities of these market participants while they negotiate and establish the necessary margining arrangements.

The OCE analysis also provides critical data on the muted impact of the proposed change on systemic risk mitigation. The estimated average AANA for phase 5 entities is $54 billion compared to an average $12.71 trillion AANA for entities in phases 1, 2 and 3, and $1 trillion for entities in phase 4. The total estimated AANA for entities that would be subject to the one year extension is approximately three percent of the total AANA of entities subject to the margin rules. In my view, this data is critical to supporting a one year extension as it indicates that the likely affect in providing the extension on systemic risk mitigation will be quite limited.

For these reasons, I concur in the issuance of the Proposal.

[3] See BCBS and IOSCO ''Margin requirements for non-centrally cleared derivatives,'' (July 2019), available at *https://www.bis.org/bcbs/publ/d475.pdf* (''July 2019 BCBS/IOSCO Margin Framework'').

[FR Doc. 2019–22954 Filed 10–23–19; 8:45 am]

BILLING CODE 6351–01–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–87327; File No. S7–18–19]

Commission Statement on Market Structure Innovation for Thinly Traded Securities

AGENCY: Securities and Exchange Commission.

ACTION: Commission statement.

SUMMARY: This Securities and Exchange Commission (''Commission'') statement (''Statement'') is intended to facilitate the development of proposals that will improve secondary market trading for equity securities that trade in lower volume (''thinly traded securities''). The Commission's interest in considering proposals for improvement in this segment of the secondary market extends to proposals that could include the suspension or termination of unlisted trading privileges (''UTP'') and/or exemptive relief from Regulation NMS and other rules under the Securities Exchange Act of 1934 (''Exchange Act'').

DATES: The Commission's statement was effective October 17, 2019.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's internet comment form (*http://www.sec.gov/rules/policy.shtml*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number S7–18–19 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–18–19. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (*http://www.sec.gov/rules/policy.shtml*). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549–1090 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file. A notification of the inclusion in the comment file of any materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Cristie March, Senior Special Counsel; Deborah Flynn, Special Counsel; Christopher Chow, Special Counsel; or Liliana Burnett, Attorney-Adviser, at 202–551–5550, in the Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

The Commission is issuing this Statement to facilitate the ability of market participants to develop innovative proposals for changes in equity market structure that are designed to improve trading in thinly traded securities. Although the Commission believes that the current equity market structure generally works well for securities that trade in higher volume, the Commission has concerns that the current ''one-size-fits-all'' equity market structure, as largely governed under Regulation NMS,[1] may not be optimal for thinly traded securities.

The secondary market for thinly traded securities faces liquidity challenges that can have a negative effect on both investors and issuers. In particular, thinly traded securities, which are often also smaller-capitalization securities, tend to have wider spreads and less displayed size relative to securities that trade in greater volume, often resulting in higher transaction costs for investors.[2] Potential investors in such securities also may be concerned that they could encounter difficulties finding the necessary liquidity to establish or unwind positions in the stocks.[3] A lack of readily available liquidity also may discourage potential market makers from electing to make markets in those

[1] *See* Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (adopting 17 CFR 242.600 through 242.613 (Regulation NMS)) (''NMS Release''). ''NMS'' stands for the National Market System.

[2] *See* Division of Trading and Markets Data Paper: Empirical Analysis of Liquidity Demographics and Market Quality, April 10, 2018, *available at https://www.sec.gov/files/thinly_traded_eqs_data_summary.pdf,* at 1 (summarizing the quoting and trading characteristics of NMS stocks on the lower end of the liquidity spectrum).

[3] *See, e.g.,* Transcript for Roundtable on Market Structure for Thinly-Traded Securities, April 23, 2018, *available at https://www.sec.gov/spotlight/equity-market-structure-roundtables/thinly-traded-securities-rountable-042318-transcript.txt* (''Transcript''), at 35; *see also* Thierry Foucault, Ohad Kadan & Eugene Kandel, *Liquidity Cycles and Make/Take Fees in Electronic Markets,* 68 J. Fin. 299 (2013) (discussing the externality of liquidity demand increases resulting in the increasing supply of liquidity, and an exogenous increase in the supply of liquidity resulting in an increase in the demand for liquidity).

securities.[4] For these reasons, a thinly traded security could affect a potential investor's willingness to invest in that issuer's securities, possibly resulting in even fewer trades.[5] Having a less liquid security also could negatively affect an issuer's financing (*e.g.,* the cost of capital).[6] Staff in the Division of Trading and Markets has issued a paper providing additional background on the unique trading challenges and characteristics related to thinly traded securities.[7]

The Commission recognizes there are various factors that affect the liquidity of a security and that market structure changes can address only part of the overall listing and trading environment for thinly traded securities. However, the Commission believes that there are a number of market structure changes [8] that could improve secondary market trading for thinly traded securities and is therefore issuing this Statement to encourage innovative approaches in this regard.[9]

II. Commission Position

A. Potential Market Structure Innovations for Thinly Traded Securities

The Commission believes that certain market structure innovations that may provide benefits to thinly traded securities, when applied on one given exchange, may be less likely to succeed if the securities are subject to concurrent trading on multiple exchanges with different trading models. Accordingly, to be effective, these innovations may require the suspension or termination of UTP.[10] UTP permits securities listed on any national securities exchange to be traded by other such exchanges.[11] Currently, UTP is automatically extended to a security once it begins trading on the listing exchange.[12] Similarly, some market structure innovations related to improving markets for thinly traded securities may require relief from certain Regulation NMS or other Exchange Act rules to be effective. Therefore, for thinly traded securities, the Commission is interested in considering proposals for market structure innovations in conjunction with the potential suspension or termination of UTP and/or the possibility of exemptive relief from Regulation NMS and other rules under the Exchange Act.[13]

A number of suggested market structure approaches to improve liquidity for thinly traded securities were raised at the Roundtable and elsewhere. One approach that has been suggested is that an exchange could provide market makers with incentives to assume heightened market making obligations for thinly traded securities.[14] The concern expressed is that market makers may lack adequate incentives to quote, especially with significant order interest, at or inside the displayed best bid or offer in thinly traded securities, particularly during periods of increased volatility. Increased incentives to be in—and stay in—the markets for these securities could encourage market makers to quote more frequently and in greater size, which in turn could lead to narrower spreads and increased displayed order interest. An exchange might also explore ways to incentivize market makers to provide additional liquidity not only during normal market conditions, but also during times of market stress when liquidity in these securities can become even scarcer.

Others have suggested that an exchange could implement periodic intraday auctions as a means of concentrating liquidity in thinly traded securities at times other than solely at the market open and market close.[15] To the extent that liquidity in these securities does not efficiently coalesce when traded across multiple equity exchanges in intervals of microseconds, such an approach might facilitate more efficient order interaction and price formation by concentrating liquidity at one exchange and at distinct time intervals during the trading day.[16] Doing so may help to resolve difficulties that market participants currently have in finding contra-side liquidity, particularly for larger-size orders.

Another market structure change that has been suggested to help improve liquidity is the introduction of non-automated markets for thinly traded securities.[17] Such an approach could enable an exchange to offer a negotiated market (*i.e.,* a market that would permit buyers and sellers to communicate directly to determine an agreed upon price), whether for thinly traded securities orders generally, or for larger-size orders more specifically. Such a negotiated market might address certain

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[4] *See, e.g.,* Transcript, *supra* note 3, at 24.

[5] In addition, one Roundtable participant suggested that it also could affect a company's attractiveness to current and prospective employees. *See id.* at 21, 85–86.

[6] *See, e.g.,* Alexander W. Butler, Gustavo Grullon & James P. Weston, *Stock Market Liquidity and the Cost of Issuing Equity,* 40(2) J. Fin. & Quant. Anal. 331 (2005) (finding that stock liquidity is an important determinant of the cost of raising external capital and that investment bank fees are significantly lower for firms with more liquid stock); Jonathan Brogaard, Dan Li & Ying Xia, *Stock Liquidity and Default Risk,* 124(3) J. Fin. Econ. 486 (2007) (finding that stock liquidity reduces firm default risk by improving stock price informational efficiency and facilitating corporate governance by blockholders).

[7] *See* Securities and Exchange Commission, Division of Trading and Markets, Staff Background Paper on the Market Structure for Thinly Traded Securities (October 17, 2019), *available at https://www.sec.gov/rules/policy/2019/thinly-traded-securities-tm-background-paper.pdf* (''Staff Background Paper'').

[8] As discussed further below, market participants have suggested, for example, heightened market making obligations and market making incentives, periodic intraday auctions, non-automated auctions, and indicative quoting.

[9] Pursuant to the Congressional Review Act, the Office of Information and Regulatory Affairs has designated this policy statement as not a ''major rule,'' as defined by 5 U.S.C. 804(2). *See* 5 U.S.C. 801 *et seq.*

[10] The Commission understands that the suspension or termination of UTP may have effects on intermarket competition and, as noted below, welcomes comment on this matter and other matters raised in this Statement.

[11] 15 U.S.C. 78l(f).

[12] *See* Securities Exchange Act Release No. 43217, 65 FR 53560 (September 5, 2000) (eliminating the one-day waiting period for exchanges to extend UTP to listed IPOs).

[13] Exchanges may submit market structure innovation proposals as rule filings in accordance with Section 19(b) of the Exchange Act and the rules thereunder. *See* 15 U.S.C. 78s(b). An application to suspend or terminate UTP for thinly traded securities under Section 12(f) of the Exchange Act and the rules thereunder may be submitted to the Commission. *See* 15 U.S.C. 78l(f). Requests for exemptive relief from Regulation NMS or other rules under the Exchange Act for thinly traded securities may also be submitted to the Commission. *See* 15 U.S.C. 78mm(a). To the extent non-exchanges would like to recommend market structure innovations, those recommendations may be submitted to File Number S7–18–19 for this Statement.

[14] *See, e.g.,* Transcript, *supra* note 3, at 49, 150–52, 192–93. For example, in the past, human market makers such as New York Stock Exchange specialists were the exclusive market makers in a range of allocated securities (including those that were thinly traded and actively traded) and, as a result, had more comprehensive information about the trading interest in those securities that facilitated their ability to meet heightened affirmative and negative obligations and incentivized their quoting activity.

[15] *See, e.g.,* Yakov Amihud, Haim Mendelson & Beni Lauterbach, *Market Microstructure and Securities Values: Evidence from the Tel Aviv Stock Exchange,* 45 J. Fin. Econ. 365 (1997) (noting that adding additional auctions to the trading day on the Tel Aviv stock exchange was associated with an increase in liquidity and that some European stock exchanges already include an intra-day call auction where continuous trading is paused for a period while a call auction is performed). *See also* Transcript, *supra* note 3, at 137; Nasdaq Application to Permit Issuer Choice to Consolidate Liquidity by Suspending Unlisted Trading Privileges (April 25, 2018), *available at https://www.sec.gov/comments/265-31/26531-3515735-162293.pdf,* at 5.

[16] *See, e.g.,* Robert Schwartz & Reto Francioni, *Call Auction Trading, Encyclopedia of Finance* 477 (2013) (stating that ''[t]he electronic call auction is appealing for small and mid-cap stocks because order batching augments the efficiency of liquidity provision by focusing liquidity at specific points in time'' and that ''[f]or securities with little liquidity and less frequent trading, one or two calls per day may suffice.'').

[17] *See, e.g.,* Transcript, *supra* note 3, at 79, 124, 149–52. *See also id.* at 26 (discussing the lack of negotiated trading on exchanges).

liquidity challenges that fully continuous markets pose to thinly traded securities (*e.g.,* the increased risk of ''missing the market'' when displaying an order).[18] A related approach might be for an exchange to allow more informative indicative quoting [19] in thinly traded securities as opposed to requiring firm quoting (again, whether as a general matter or for larger-size orders), to facilitate trade negotiation and incentivize market maker participation.

The Commission notes that these potential market structure changes are merely a few examples of the types of innovations that exchanges and other market participants could consider developing that might facilitate improved trading in thinly traded securities. This list is not intended to be exhaustive or to limit the possibilities market participants could consider. The Commission encourages exchanges and other market participants, including issuers, to explore various types of market structure innovations to address the liquidity challenges in trading these securities.

B. Invitation for Proposals To Address the Market for Thinly Traded Securities

To better facilitate secondary market trading in thinly traded securities, one possible approach is for a national securities exchange that lists thinly traded securities to consider submitting a proposal focused on enhancing the market structure for these securities. To the extent a listing exchange would like to submit a proposal for an innovation that incorporates or depends on the suspension or termination of UTP, such an exchange could apply for the suspension or termination of UTP pursuant to Section 12(f) of the Exchange Act so that these securities that an exchange lists would no longer trade on other national securities exchanges.[20] As necessary to implement its proposed innovations, an exchange could submit requests for exemptive relief from Regulation NMS or other Exchange Act rules.[21] The Commission recognizes that market structure changes may not address all of the challenges faced by issuers whose securities are thinly traded. But to the extent that the current secondary market requirements could be tailored to better serve thinly traded securities without negatively affecting trading as a whole, the Commission is interested in evaluating proposals that listing exchanges may submit. The Commission notes that market structure changes to improve trading in thinly traded securities could have implications for the broader market structure. The Commission encourages any proposal to address these potential broader market structure effects. In addition, the Commission expects any proposal to demonstrate how it would satisfy any relevant statutory requirements including, for example, Section 6, Section 11A, and Section 12 of the Exchange Act.[22] The Commission would evaluate any proposals pursuant to such relevant statutory requirements.

To facilitate the Commission's evaluation, it would be helpful for a proposal to address certain considerations. For example, a proposal should define what ''thinly traded security'' means, whether based on average daily trading volume, number of trades, share volume, or dollar volume, potentially combined with additional factors such as market capitalization, number of shareholders, or public float. Such proposals should also include an explanation of how the thresholds were set, including any relevant data and analysis.

The proposal should address whether all securities that meet a chosen threshold test are included in the tier, or whether listed companies may opt in or out. If listed companies may opt in or out, the proposal should also address how the benefit of this mechanism justifies the potential additional operational complexity this may impose on NMS market participants.

To the extent relevant, the Commission encourages exchange proposals that involve the suspension or termination of UTP to address: (1) Steps that might be taken to enhance the technological resilience of its new trading tier in light of the greater dependence of market participants on a single exchange; and (2) business continuity plan(s) in the event of the failure of an exchange's systems that would affect trading in, and required quote and trade information dissemination regarding, the thinly traded securities.

The Commission encourages all proposals to address: (1) How and when a security would begin trading in the thinly traded security tier, and how it would transition out of the tier if that security no longer qualifies for trading in the tier; (2) how the exchange would address NMS Plan market data revenue allocation for any thinly traded securities not subject to UTP; and (3) the data the exchange would collect and make available and the data analysis it would conduct to enable an assessment of the success of the proposal.[23] A proposal also could consider the collection and sharing of data to measure the market-wide effects of: (i) Limiting trading of the affected securities to a single exchange, including any market quality benefits or costs that may result from consolidating the liquidity pool; (ii) relief from Exchange Act rules that restrict the ability of exchanges to innovate beyond the fully continuous market models that exist today; and (iii) any other innovative market structure modifications. The Commission welcomes comments on matters addressed in this Statement, including any potential effects on intermarket competition for listing and trading thinly traded securities, as well as related potential effects on market transparency and the protection of investors.

The Commission looks forward to engaging with exchanges that list and trade thinly traded securities, market participants involved in this segment of the equities market, including issuers, investors, and others to facilitate market structure innovations that can meaningfully improve secondary market trading for these securities.

By the Commission.

Dated: October 17, 2019.

Eduardo A. Aleman,

Deputy Secretary.

[FR Doc. 2019–22994 Filed 10–23–19; 8:45 am]

BILLING CODE 8011–01–P

[18] This situation arises, for instance, when a displayed order is posted to a continuous market. The displayed order signals a buy or sell intention to the market, but instead of the displayed order being filled, a separate trade occurs either at or slightly better than the initially displayed price. Because the market consequently moves away from the initially displayed price, the initial posted order goes unexecuted. *See also* Staff Background Paper, *supra* note 7, at 12 (describing the Roundtable discussions of the difficulties in filling orders).

[19] *See, e.g.,* Transcript, *supra* note 3, at 80–81 (stating that indications of interest currently often are static or stale). An indicative quote is an expression of interest to transact designed to attract the contra side of the trade but that is not a firm quote.

[20] *See* 15 U.S.C. 78l(f).

[21] At this time, the Commission's initiative is focused on encouraging on-exchange innovation for thinly traded securities and is not intended to address OTC trading of these securities.

[22] *See* 15 U.S.C. 78f, 15 U.S.C. 78k–1, and 15 U.S.C. 78l, respectively.

[23] In so doing, an exchange could consider describing how it could evaluate the success of a proposal, including: (i) The data that could be collected; (ii) the testing and comparative analysis based on specified metrics that could be conducted to determine the effectiveness of the program; (iii) an explanation of the statistical approach it could employ in its testing and comparisons; and (iv) the empirical analysis it could perform.